ORGANISATION DE COOPÉRATION ET DE DÉVELOPPEMENT ÉCONOMIQUES

Volatility in agricultural commodity markets: Towards some policy responses

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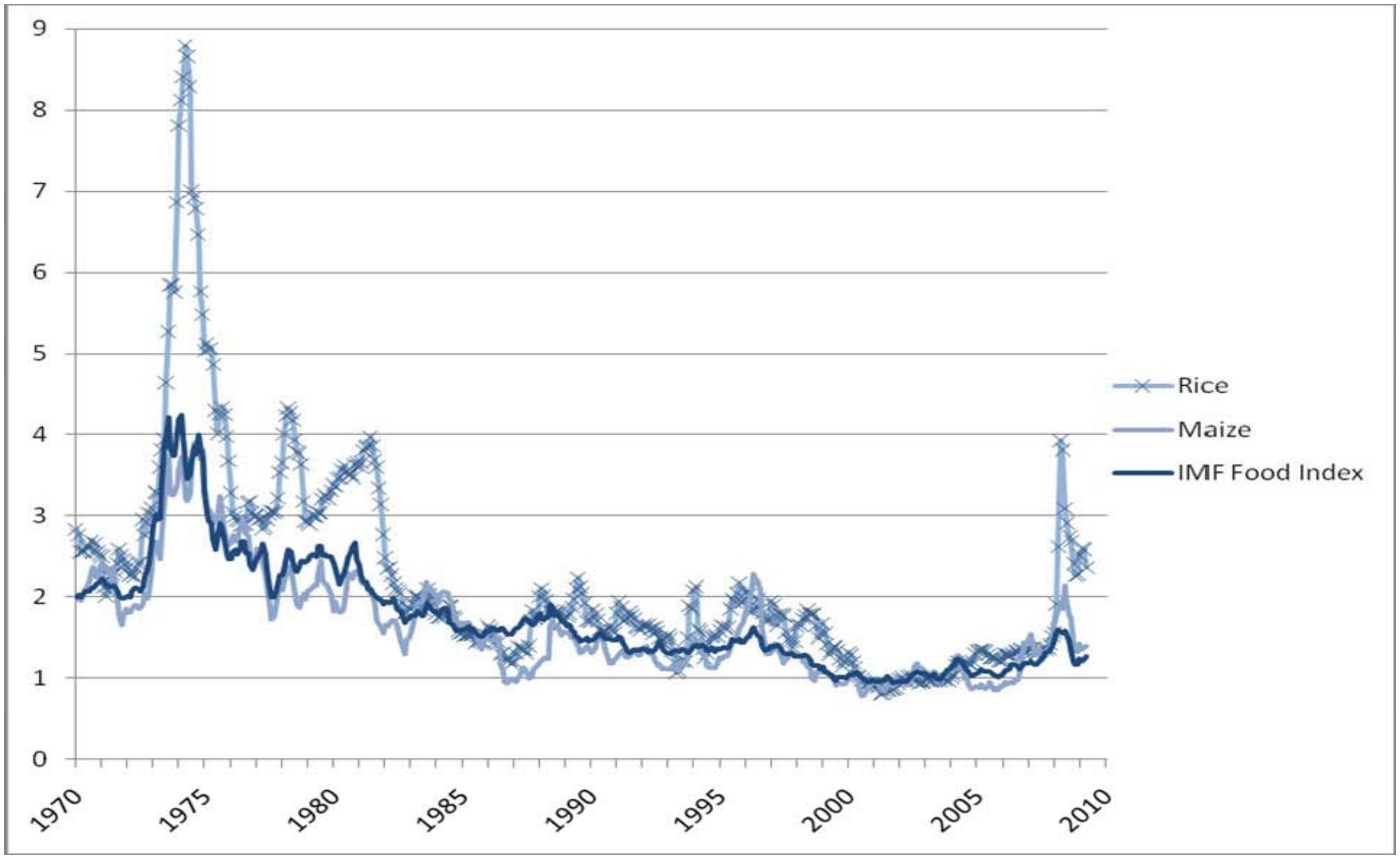
Part 1

food price spikes: causes

Real Commodity Prices

Food and Agricultural
1970 - 2009

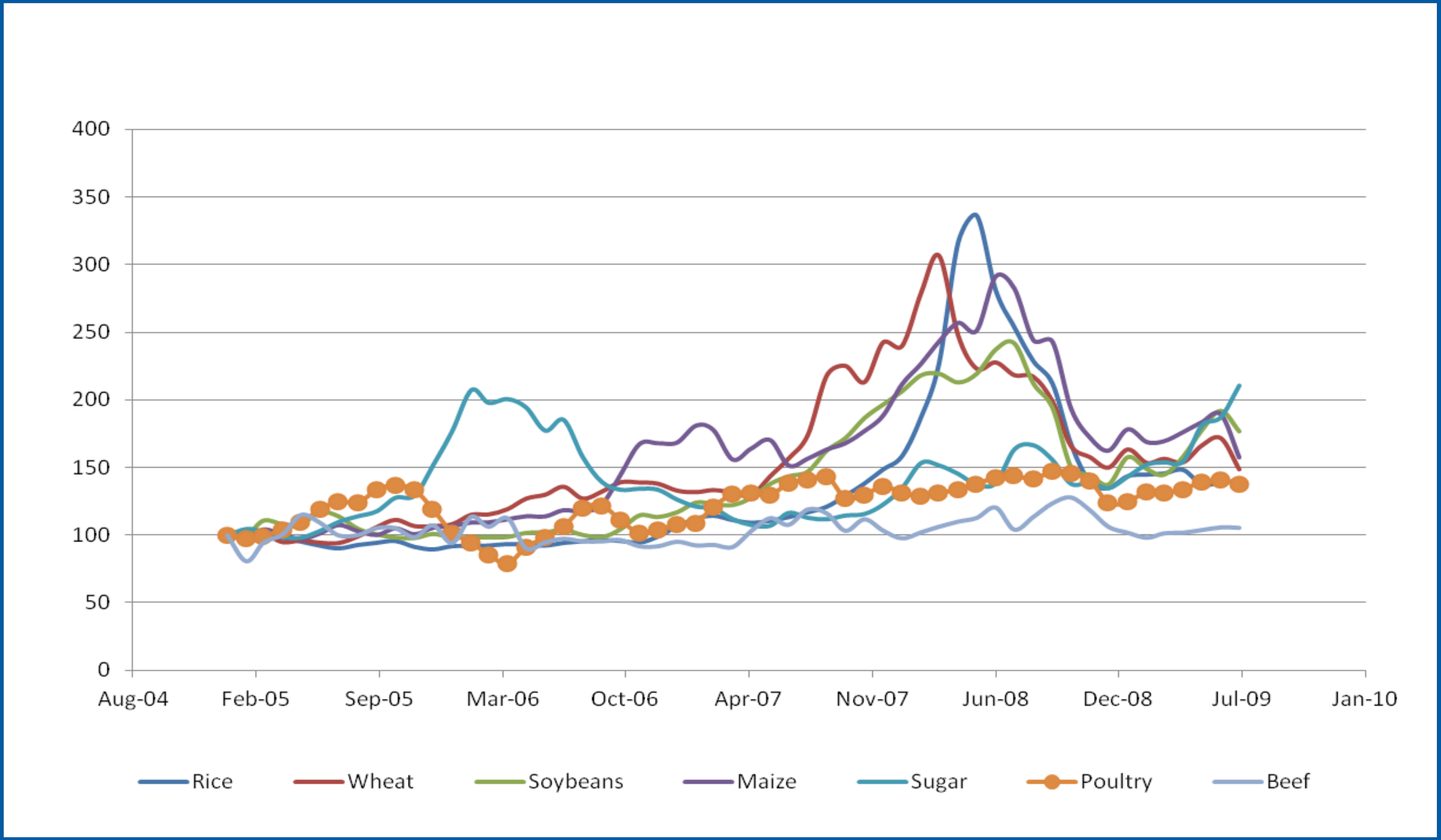


(indices, 2002=1)

Source: IMF, *International Financial Statistics*, 2009.

Food Crop Prices co-movement

2004 - 2010

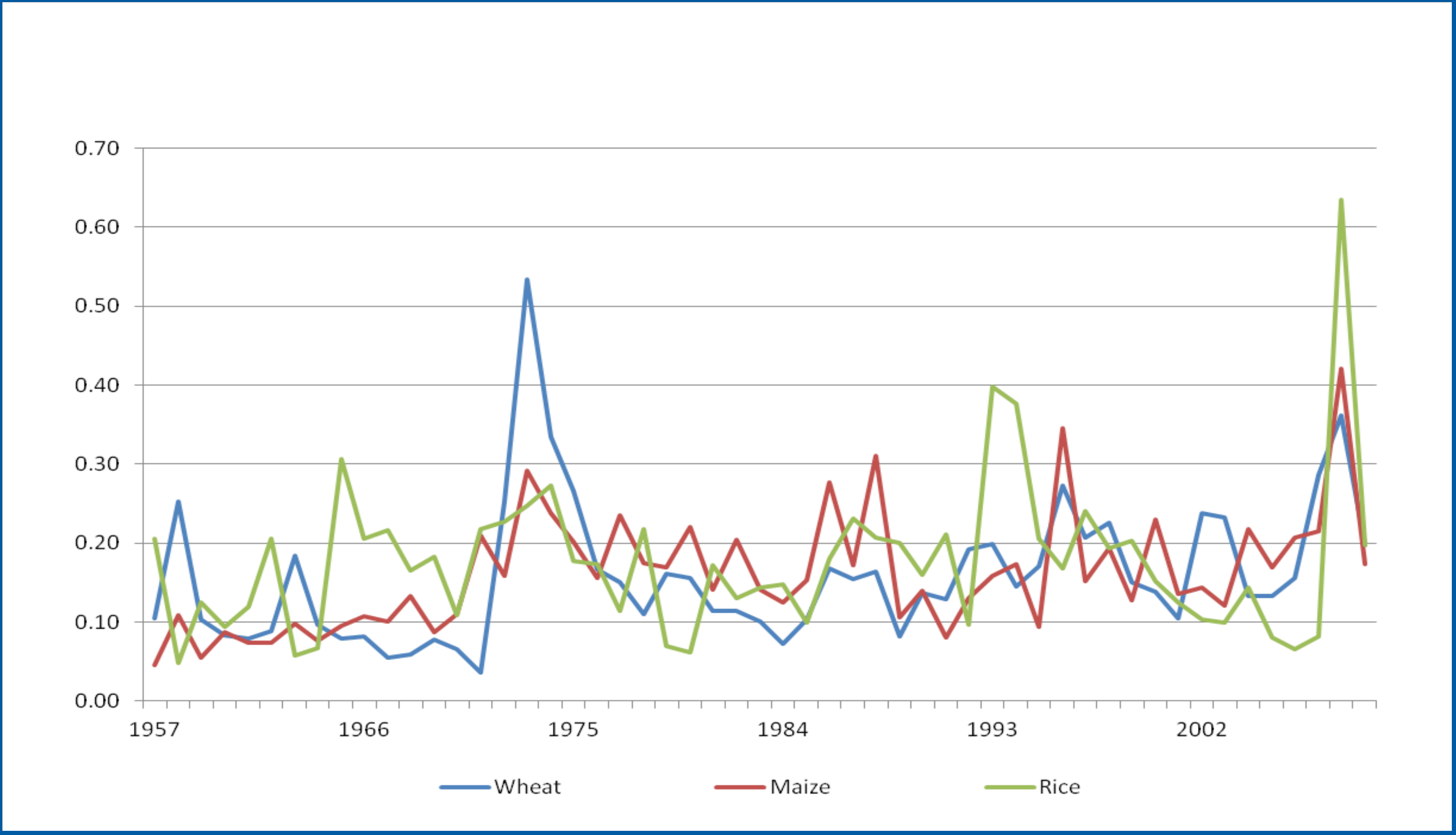


(indices, 2005=100)

Source: OECD-FAO Agricultural Outlook 2010-2019

Cereal Commodities

Nominal Annualised Historic Volatility
1957 - 2010



Source: OECD-FAO Agricultural Outlook 2010-2019

Overview

Weather problems, Drought	Increase in use of agricultural feedstocks for bio-fuels	•Speculation on commodity derivative markets •Hoarding
Export restrictions	Increase in demand for food and animal feed from emerging countries	Effects of climate change Water scarcity
Exchange rate fluctuations	Historically low stock levels	Technology, Yields

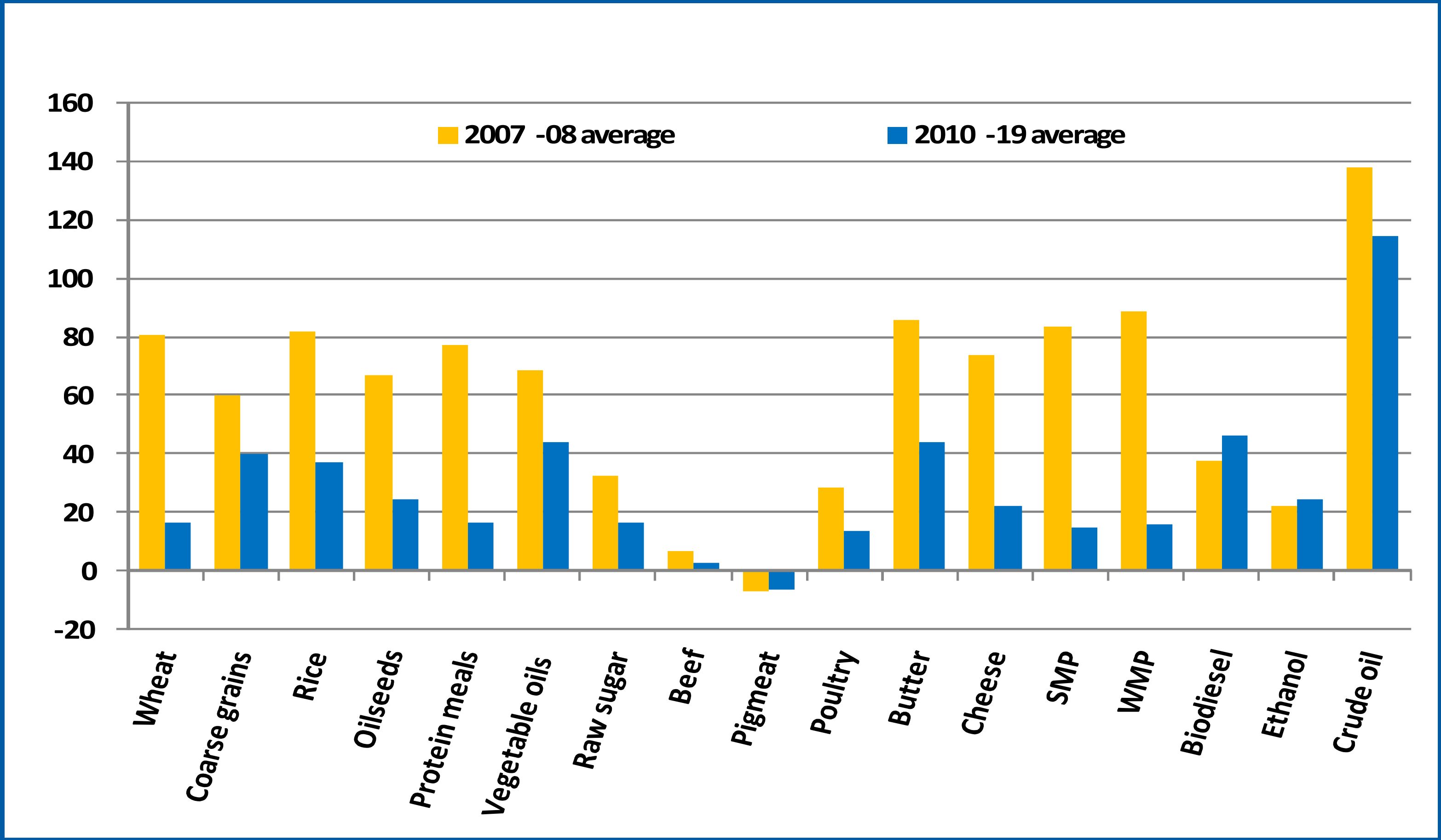
Is volatility likely to increase?

- De-regulating reforms
- Low stocks
- Links to energy markets
- Production moving to less resilient areas
- Climate change increasing the frequency of extreme event
- Speculation

- New technologies increasing resilience
- More open trade leading to less thin markets
- Better information flows

OECD/FAO Price Projections

World Prices in real Terms
Percentage change relative to 1997-2006



Source: OECD-FAO Agricultural Outlook 2010-2019

Objectives

- Help the most severely affected *consumers* cope with high prices
- Help *producers* cope with low, uncertain and excessively volatile prices
- Allow *market* signals to reflect underlying supply and demand conditions

One size will not fit all

Measures

- Prevention
- Readiness
- Resilience

Actors

- International
- Governments
- Individuals

Part 2

Policy response

International Level

Short Term

- Emergency response capacity:
  - More stable and predictable financing framework
  - Financial mechanisms for the poorest net importing countries

Longer term

- Export Restrictions
- Information systems and transparency especially (especially stocks)
- DDA: the risk of excessive volatility associated with « thin » markets will be reduced

National Level

Short Term

- In the short-term, targeted emergency measures, safety nets for the most vulnerable

Longer term

- Develop stockholding mechanisms with well-defined operational rules
- Re-think biofuels policies
- Invest in agriculture to improve productivity and resilience

Producer Risk

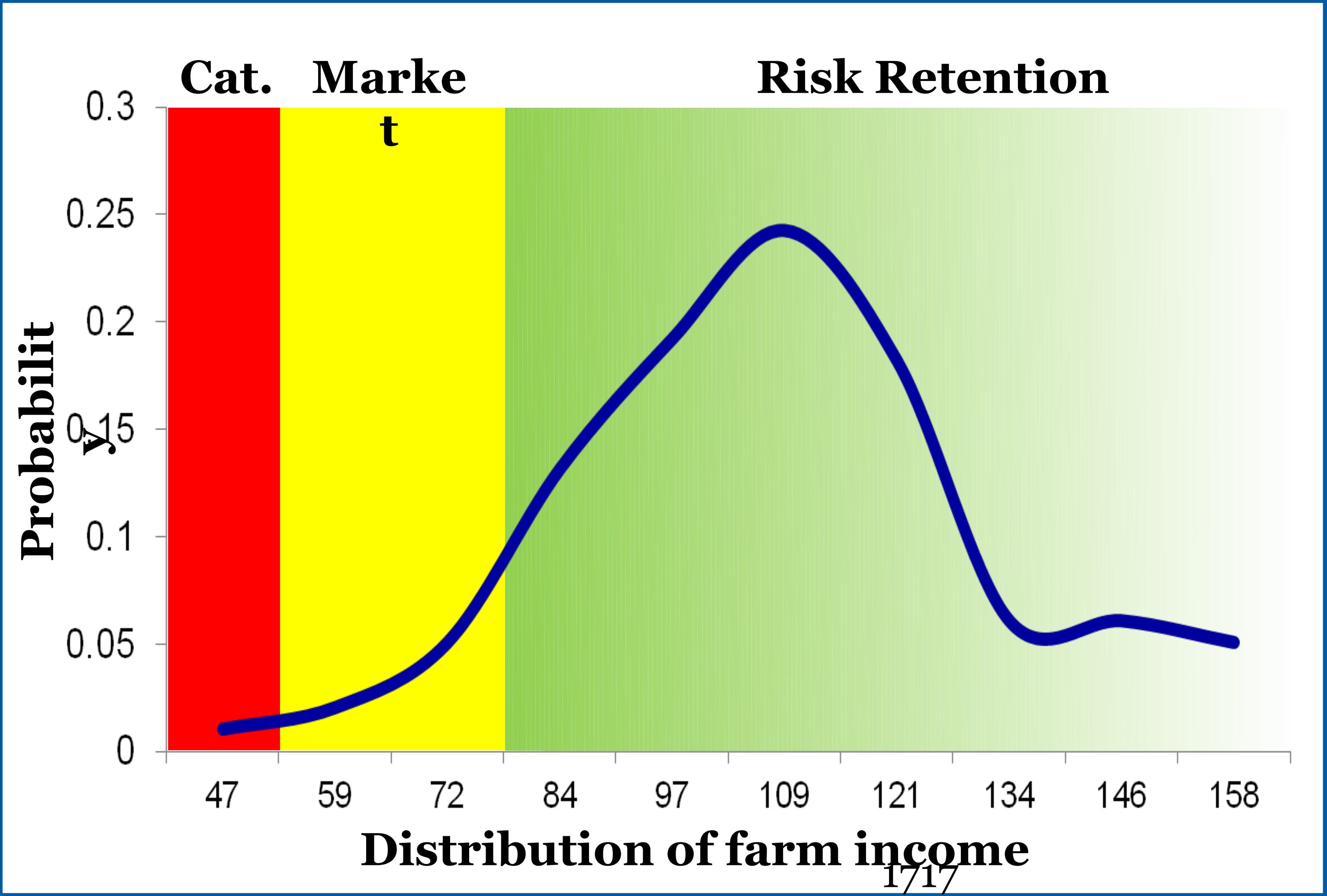
Integrate volatility into a wider risk management strategy

- Diversification at the enterprise and household level
- Smoothing mechanisms – save in good years with the help of the tax system, or tailored schemes
- Use market instruments – futures, insurance
- Catastrophic situations call for government intervention, but with well defined conditions and terms

Three Risk Layers

Layer	Catastrophic	Market	Risk Retention
Frequency	Low	Medium	High
Damage	High	Medium	Low
Examples	Floods and Droughts	Specific perils (hail, larger price variations) with potential for market instruments	Normal weather variations and changes in market conditions

Three Risk Layers
Different Policy Implications



Part 3

Was financial speculation to blame?

Was Financial Speculation to Blame?

Arguments For

- Deregulation in the US in 2000 in important (commodity derivatives)markets.
- Huge increase in commodity index investment – non-traditional investors.
- Rapidity of the price increases and subsequent falls

Was Financial Speculation to Blame?

Arguments Against

- Many plausible and well documented, other contributory factors:
  - supply and demand shocks,
  - exchange rates
  - low stocks
  - hoarding
  - inelastic supply and demand)
  - Other factors
- Evidence from other commodities, other exchanges.
- Preliminary evidence (Irwin and Shaw).

Part 4

Conclusion

One man's meat is another man's poison

- Multiple factors affecting *multiple actors* in very different ways
- An incomplete understanding of the *past* and much uncertainty about the *future*
- *Known needs* can only be met by a resilient and responsive sector exposed to market signals
- So *one size fits all* solutions cannot work

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